

**38 CFR Part 36****2900-AR58****Loan Guaranty: Revisions to VA-Guaranteed or Insured Interest Rate****Reduction Refinancing Loans**

**AGENCY:** Department of Veterans Affairs.

**ACTION:** Proposed rule.

**SUMMARY:** The Department of Veterans Affairs (VA) proposes to amend its rules on VA-backed interest rate reduction refinancing loans (IRRRLs). The Economic Growth, Regulatory Relief, and Consumer Protection Act and the Protecting Affordable Mortgages for Veterans Act of 2019 outlined the circumstances in which VA may guarantee or insure refinance loans, by setting forth net tangible benefit, recoupment, and seasoning standards. The proposed rule would update VA's existing IRRRL regulation to current statutory requirements.

**DATES:** Comments must be received on or before [insert date 60 days after date of publication in the FEDERAL REGISTER].

**ADDRESSES:** Comments must be submitted through [www.regulations.gov](https://www.regulations.gov). Except as provided below, comments received before the close of the comment period will be available at [www.regulations.gov](https://www.regulations.gov) for public viewing, inspection, or copying, including any personally identifiable or confidential business information that is included in a comment. We post the comments received before the close of the comment period on the following website as soon as possible after they have been received: <http://www.regulations.gov>. VA will not post on Regulations.gov public comments that make threats to individuals or institutions or suggest that the

commenter will take actions to harm the individual. VA encourages individuals not to submit duplicative comments. We will post acceptable comments from multiple unique commenters even if the content is identical or nearly identical to other comments. Any public comment received after the comment period's closing date is considered late and will not be considered in the final rulemaking.

**FOR FURTHER INFORMATION CONTACT:** Terry Rouch, Assistant Director, Loan Policy and Valuation, and Stephanie Li, Chief, Regulations, Loan Guaranty Service (26), Veterans Benefits Administration, Department of Veterans Affairs, 810 Vermont Avenue NW, Washington, DC 20420, (202) 632–8862 (This is not a toll-free telephone number.)

**SUPPLEMENTARY INFORMATION:** The proposed rulemaking described by this notice would update VA's existing IRRRL regulation at 38 CFR 36.4307 to reflect current statutory requirements set forth by section 309 of the Economic Growth, Regulatory Relief, and Consumer Protection Act, Pub. L. 115–174, 132 Stat. 1296, and section 2 of the Protecting Affordable Mortgages for Veterans Act of 2019, Pub. L. 116-33, 133 Stat. 1038 (collectively, the “Acts”). The subject provisions of the Acts are codified at 38 U.S.C. 3709. Section 3709 sets forth statutory criteria for determining whether VA can guarantee or insure a refinance loan. Additional statutory authorities underpinning VA's proposed rulemaking include 38 U.S.C. 3710, 3703, and 501. IRRRLs are specifically authorized under subsections (a)(8), (a)(11), and (e) of 38 U.S.C. 3710.

## **I. Background**

(Note: VA does not use the term IRRRL in the proposed rule text. For ease of reading, however, this preamble substitutes the term “IRRRL” for the proposed rule text’s “refinancing loan”. The terms are interchangeable in this context.)

#### *A. Section 3709 Background Discussion*

##### **1. IRRRLs Described**

The purpose of an IRRRL is to improve a veteran’s financial position by reducing the interest rate on the veteran’s existing VA-backed loan. An IRRRL typically results in a reduction in the dollar amount the veteran owes toward monthly housing loan payments. See 38 CFR 36.4307(a)(3). An IRRRL may be used alternatively to reduce the veteran’s required number of monthly loan payments, to convert an adjustable-rate mortgage (ARM) to a loan with a fixed interest rate, or to make energy efficient improvements to the home. *Id.* A veteran cannot use an IRRRL to obtain cash for the equity the veteran may have in the property securing the loan, because that would be a cash-out refinance. See 38 CFR 36.4306.

##### **2. Section 3709’s Effect on IRRRLs**

VA-backed refinancing loans were historically divided into two categories. See Revisions to VA-Guaranteed or Insured Cash-Out Home Refinance Loans, 83 FR 64459 (Dec. 17, 2018). The two categories were cash-outs offered under 38 U.S.C. 3710(a)(5) or 3710(a)(9) and IRRRLs. *Id.*

As VA noted in its cash-out refinance interim final rule (IFR) notice, Congress structured 38 U.S.C. 3709 such that VA-backed refinance loans have since been effectively grouped into three categories: i) IRRRLs, ii) cash-outs in which the amount of the principal for the refinancing loan is equal to or less than the payoff amount on the loan being refinanced (Type I Cash-Outs), and iii) cash-outs in which the amount of the principal for the refinancing loan is larger than

the payoff amount of the loan being refinanced (Type II Cash-Outs). 83 FR at 64459. Subsections (a) through (c) of section 3709 apply to IRRRLs. *Id.* at 64460. Each of these three subsections creates a pass/fail standard applicable to IRRRLs. If one or more of the requirements is not met, VA cannot guarantee the IRRRL. See *id.* at 64462.

### *B. Rulemaking Purpose*

VA is proposing to revise 38 CFR 36.4307 to reflect current statutory requirements, including net tangible benefit, recoupment, and seasoning standards, consistent with 38 U.S.C. 3709. Also, because section 3709 has caused confusion among program participants, VA is proposing clarifications to diminish the risk of lender noncompliance. In helping lenders understand compliance expectations, VA's regulation would safeguard veterans, ease lender concerns, reduce potential instability in the secondary loan market, and insulate taxpayers from unnecessary financial risk. Ultimately, VA's regulation would help ensure that IRRRLs continue to be used for their intended purpose, that is, improving veterans' financial positions.

Additionally, VA proposes certain technical changes (described below) for ease of reading and proposes using a redesigned VA Form 26-8923, *IRRRL Worksheet*, which is the worksheet that lenders complete when making IRRRLs, to collect certain lender certifications. The proposed redesigned *IRRRL Worksheet* is described in more detail later in this notice.

### *C. Qualified Mortgage Standards and the Proposed Rule*

On May 9, 2014, VA published an IFR notice to describe which VA-guaranteed loans were to be considered as "qualified mortgages" (QM), thereby subject to either safe harbor protection or the presumption that the veteran is able to repay a loan, in accordance with the Ability to Repay provisions that

existed at the time. See *Loan Guaranty: Ability-to-Repay Standards and Qualified Mortgage Definition Under the Truth-in-Lending Act*, 79 FR 26620 (May 9, 2014). The QM IFR did not change VA's regulations or policies with respect to how lenders are to originate mortgages, except to the extent lenders seek to make qualified mortgages. *Id.* at 26625. On October 9, 2018, VA published an agency determination regarding the status of the QM IFR, explaining that, due to enactment of section 309 of the Economic Growth, Regulatory Relief, and Consumer Protection Act (Pub. L. 115-174), VA would need to revise its QM criteria in a future rulemaking, wherein VA would take into account the spirit of the comments submitted in response to the QM IFR. See *Loan Guaranty: Ability-to-Repay Standards and Qualified Mortgage Definition Under the Truth-in-Lending Act*, 83 FR 50506 (Oct. 9, 2018). The agency determination also stated that until VA conducted a new rulemaking relating to QMs and IRRRLs, the QM IFR would remain in effect, except for any provision of the IFR that conflicted with or was superseded by Public Law 115-174. *Id.* As with the agency's previous determination, VA is not proposing in this notice to make express changes to the QM standards. Accordingly, all provisions of the QM IFR that do not conflict with or have not been superseded by later-in-time provisions of law continue to remain in effect.

## **II. Analysis of the Proposed Rule**

### ***A. Recoupment (38 CFR 36.4307(a)(8))***

In 38 U.S.C. 3709(a), Congress set forth a maximum recoupment period of 36 months for certain charges associated with an IRRRL. VA proposes to add a new paragraph (a)(8) in § 36.4307 which would clarify the statutory recoupment standard. Consistent with section 3709(a), proposed paragraph (a)(8)(i) would state that the lender of the IRRRL must provide the Secretary with a certification

that all fees, closing costs, and expenses (other than taxes, amounts held in escrow, and fees paid under 38 U.S.C. chapter 37) that would be incurred by the veteran as a result of the refinance are scheduled to be recouped on or before the date that is 36 months after the note date of the IRRRL. VA proposes to collect lenders' certifications via the redesigned VA Form 26-8923, *IRRRL Worksheet*, discussed in more detail below.

To help veterans and lenders understand how the recoupment period is calculated, VA proposes to describe a formula in proposed paragraph (a)(8)(ii). The formula would require lenders first to total the dollar amounts of all fees, closing costs, and expenses, whether included in the loan or paid at or outside of closing. The lender would then subtract from that total the dollar amounts of lender credits, if any. The resulting figure would be used as the formula's numerator (the numerator). The denominator of the formula would be the dollar amount by which the veteran's monthly payment for principal and interest would be reduced as a result of the IRRRL (the denominator). In a final calculation, lenders would divide the numerator by the denominator to determine the number of months it would take for the veteran to recoup the subject IRRRL costs:

$$\frac{(\text{fees} + \text{closing costs} + \text{expenses}) - \text{lender credits}}{\text{reduction in monthly payment of principal and interest}} = \text{months to recoup costs}$$

#### 1. Recoupment Numerator

VA proposes to clarify in paragraph (a)(8)(iii) that the numerator to be used in the formula described above is the dollar amount equating to the sum of all fees, closing costs, and expenses that would be incurred by the veteran as a result of the refinance. VA also proposes that, except as provided in paragraph (a)(8)(iii), such sum includes any charge that is incurred by the veteran as a

result of the refinance, including taxes that are not described in paragraph (a)(8)(iii)(C). VA proposes to specify in paragraph (a)(8)(iii) that lender credits may be subtracted from other amounts in the numerator.

Proposed paragraph (a)(8)(iii) would also contain a list of items that are excluded from the numerator: (A) the loan fee as prescribed by 38 U.S.C. 3729; (B) prepaid interest and amounts held in escrow (for example, amounts for hazard insurance); and (C) taxes and assessments on the property, even when paid outside of their normal schedule, that are not incurred solely due to the refinance transaction (for example, property taxes and special assessments).

*a. Understanding the “fees, closing costs, and expenses” to be recouped within 36 months*

There has been confusion among stakeholders as to the fees, closing costs, and expenses that must be recouped under section 3709(a). Subsection (a) establishes a standard but uses unclear terms and phrasing across its three paragraphs. The lack of clarity has led to uncertainty and various interpretations among program participants. To dispel the confusion, VA proposes regulatory clarification.

VA interprets subsections (a)(1) and (a)(2) to refer to the same group of charges. Specifically, subsection (a)(1)’s phrase, “fees, closing costs, and any expenses (other than taxes, amounts held in escrow, and fees paid under this chapter) that would be incurred by the borrower in the refinancing of the loan” is the antecedent to subsection (a)(2)’s phrase, “all of the fees and incurred costs” in 38 U.S.C. 3709(a)(2). This means that the fees, closing costs, and any expenses (except those expressly excluded) in paragraph (a)(1) comprise all charges—not a select collection of charges—resulting from the IRRRL and must,

under paragraph (2), “be recouped on or before the date that is 36 months after” the IRRRL is made. 38 U.S.C. 3709(a).

VA bases this interpretation on rules of grammar and usage that suggest Congress’s use of the definite article “the” in subsection (a)(2)’s clause, “all of the fees”, establishes a grammatical connection to, and dependence on, subsection (a)(1)’s reference to “fees”. The connection and dependence are furthered by subsection (a)(2)’s reference to “incurred costs”, which operates as a truncated reference back to subsection (a)(1)’s list of charges “incurred by the borrower.” In short, subsection (a)(2) should not be taken on its own. It is part of a whole and should be read in that context.

An alternative reading of section 3709(a)(1) and (a)(2) would be that these clauses should be interpreted differently because Congress phrased the clauses differently. Under such a reading, lenders would certify to VA as to one set of fees, closing costs, and expenses as described in subsection (a)(1). The only charges to be included in the recoupment period of 36 months, however, would be subsection (a)(2)’s “all of the fees and incurred costs”, where “incurred costs” is a distinctly new and undefined term. In other words, the different phrasing in subsection (a)(2) would create a second and distinct recoupment standard alongside the one prescribed in subsection (a)(1).

VA believes that requiring two separate recoupment standards as outcomes of a single statutory sentence would inject unnecessary complexity into the statutory scheme. It is VA’s position that the text of section 3709(a)’s anti-predatory lending scheme instead creates a harmonious, albeit not always textually clear, recoupment standard for stakeholders. See Pub. L. 115-174 § 309, “Protecting Veterans from Predatory Lending” (May 24, 2018); *Gustafson v. Alloyd Co.*, 513 U.S. 561, 569 (1995) (holding that courts must interpret statutes



“as a symmetrical and coherent regulatory scheme”); *FTC v. Mandel Brothers, Inc.*, 359 U.S. 385, 389 (1959) (directing courts to “fit, if possible, all parts [of a statute] into an harmonious whole”).

In viewing “incurred costs” as a reference to a previously used term rather than the introduction of a new one, VA’s interpretation would eliminate the need for program participants to go beyond the statutory language and hypothesize and debate Congress’s intent. At the same time, VA’s rationale for interpreting the text would align with and further the Congressional aim of enacting section 3709 and the IRRRL benefit. For example, it would save veterans and lenders from bearing the burden of deciphering separate recoupment outcomes, one for certifying to VA under paragraph (1) and another for determining under paragraph (2) whether the loan could be guaranteed. Additionally, VA’s approach would result in a more transparent and easier-to-administer oversight requirement. It would also reduce the risk of errors and loopholes to which an alternate reading is more vulnerable. Finally, it would avoid unnecessary complexity, reducing the likelihood of veterans suffering confusing and convoluted outcomes. Each of these factors would help prevent predatory lending and ensure that a veteran has the opportunity to understand whether an IRRRL is in the veteran’s financial interest.

For similar reasons, VA interprets subsection (a) to refer to charges the veteran actually paid and that were incurred as a result of the refinance transaction. The veteran could pay such charges before closing, at closing, or by including such charges in the loan amount.

*b. Charges not included in the recoupment numerator*

Generally, no charge can be made against, or paid by, a veteran unless compliant with 38 CFR 36.4313. To assist lenders in understanding what types of

borrower-incurred charges would be added in the recoupment numerator, VA proposes in section 36.4307(a)(8)(iii) to expressly list those amounts that are not to be included. In other words, any charge not enumerated in VA's proposed list would need to be included in the numerator.

The first charge VA proposes to exclude is the loan fee (more commonly referred to as the "funding fee") paid pursuant to 38 U.S.C. 3729. This exclusion is explicitly required under section 3709(a)(1). See 38 U.S.C. 3709(a)(1) parenthetical's exclusion of "taxes, amounts held in escrow, and fees paid under [38 U.S.C. chapter 37]". Section 3709(a)(1) also provides that "amounts held in escrow" are to be excluded from the recoupment calculation, which is why VA proposes to exclude them from the recoupment numerator. *Id.*

Although section 3709(a)(1) does not expressly exclude prepaid interest, VA is proposing to exclude it from the recoupment calculation. VA believes this exclusion is necessary because the per diem interest, which is often referred to as "prepaid interest", is not a fee, closing cost, or expense incurred in the refinance transaction. Rather, prepaid interest is incurred outside the refinance transaction, as the same per diem interest would accrue on the loan being refinanced regardless of the refinance. Put another way, a veteran's prepayment of interest at the time of loan closing is a matter of scheduling, not a new charge incurred in the refinancing. To view it otherwise would unduly restrict veterans from taking advantage of their home loan benefits, as lenders would refuse to accept a novel treatment of prepaid interest that requires lenders to absorb the costs. VA notes, too, that VA's proposal would ensure that a veteran who closes the IRRRL earlier in a month (and therefore must prepay more in interest) is not put at a disadvantage when compared to a veteran who closes toward the end of a month. Therefore, VA proposes to exclude prepaid interest from the numerator.

Finally, the above-referenced parenthetical in section 3709(a)(1) states that “taxes” are to be excluded from calculation of items to be recouped. VA interprets the term “taxes” to be limited to ad valorem property taxes and analogous assessments. VA bases this understanding on the real estate finance industry’s common usage of the term “taxes”; for instance, when calculating PITI (Principal, Interest, Taxes, and Insurance). This understanding is also consistent with Congress’s instruction that the amounts to be recouped are those “incurred by the borrower in the refinancing.” 38 U.S.C. 3709(a)(1). Much like prepaid interest, certain taxes and assessments might normally be paid by the veteran on a schedule (for example, monthly payments to an escrow account), but because of the refinance transaction, must be paid by the veteran ahead of their normal schedule. Payment of these amounts is a matter of timing, not a new charge attributable to the refinancing transaction itself. Conversely, other items charged during a refinance that may be referred to as “taxes”, such as intangible taxes, tax stamps, and recording taxes, are transaction costs incurred as a result of the refinance. Such charges are not normally mentioned in the industry as “taxes” like those described by PITI but are instead viewed as closing costs or expenses incurred solely due to the refinance transaction. This is why VA is not proposing to exclude these types of charges from the recoupment calculation. Thus, the result would be that only those taxes that are charged because of the refinance should be included in the recoupment numerator. This furthers the goal that the recoupment standard will generally demonstrate whether the true cost of the refinance can be recouped within the prescribed 36-month period.

In sum, by listing the charges to be excluded from the recoupment numerator, VA is not proposing to provide an exhaustive list of all charges that must be recouped within the prescribed period, but instead proposes exclusions

that are consistent with section 3709(a). Where appropriate, VA has provided examples to promote a better understanding of such charges. To the extent the scope of these exclusions may require additional clarity, VA invites comments for consideration.

*c. Lender credits*

For purposes of the recoupment numerator, VA proposes that lender credits may be subtracted from other amounts in the numerator. Lenders offer lender credits for several reasons, most commonly to provide the veteran with the option to reduce up-front costs in exchange for paying a higher interest rate on the loan. But section 3709 is silent on how to treat lender credits in relation to the recoupment standard.

Allowing lenders to subtract the amount of such credits from the recoupment numerator is consistent with VA's position that the numerator should measure the transaction costs incurred as a result of the refinance transaction. Prohibiting lender credits as offsets would not only skew the true transaction costs incurred by the veteran but also run counter to the industry norm. See, for example, 12 CFR 1026.38(h)(3), which recognizes lender credits as a type of offset to closing costs. It would also put veterans at a disadvantage when compared to other borrowers and would, in VA's view, unfairly decrease veterans' opportunities to refinance.

While lender credits usually coincide with the veteran paying a higher interest rate, Congress provided in subsection (a) two safeguards against lenders using their credits to circumvent the recoupment standard. First, Congress established the safeguard that the recoupment must be "calculated through lower regular monthly payments (other than taxes, amounts held in escrow, and fees paid under this chapter) as a result of the refinanced loan." 38 U.S.C. 3709(a)(3).

This means that, even though the lender credit would be subtracted under VA's proposed rule from the numerator's charges, the recoupment formula's denominator (described in more detail below) would look to the regular monthly payments to account for the potential loss of savings attributable to the slightly increased interest rate.

Second, Congress has established separate interest rate limitations that prevent predatory interest rate increases. For instance, 38 U.S.C. 3709(b) sets parameters around interest rates, values, and discount points. As mentioned above, VA proposes regulations to implement this statutory interest rate safeguard for IRRRLs, as explained later in this notice. Another interest rate limitation on IRRRLs is provided in 38 U.S.C. 3710(e)(1)(A). Permitting lender credits to be included in the recoupment calculation would not override such requirements. VA notes, too, that lender credits would not affect the loan seasoning provisions outlined in section 3709(c). In sum, VA's proposal to account for lender credits in the recoupment calculation would reflect the fees, closing costs, and expenses a veteran would incur as a result of the refinance—both at the time of refinance and over the repayment term—while preserving for the veteran the option to lower their up-front closing costs via lender credits.

## 2. Recoupment Denominator

With respect to the denominator of the recoupment calculation formula, VA proposes to state in paragraph (a)(8)(iv) that the denominator is the dollar amount by which the veteran's monthly payment for principal and interest is reduced as a result of the refinance. The proposed paragraph would prescribe that the reduction is calculated by subtracting the veteran's monthly payment for principal and interest under the IRRRL from the veteran's monthly payment for principal and interest under the loan being refinanced. VA would also clarify that

when calculating monthly payments for principal and interest, the lender must use the full payment, without omitting any amounts to be repaid monthly by the veteran and attributable to, for example, financed fees, financed funding fees prescribed by 38 U.S.C. 3729, financed closing costs, and financed expenses.

In proposing this standard, VA is clarifying that the phrase “lower regular monthly payments (other than taxes, amounts held in escrow, and fees paid under this chapter)” in 38 U.S.C. 3709(a)(3) means the difference between the veteran’s monthly payment for principal and interest under the IRRRL and the veteran’s monthly payment for principal and interest under the loan being refinanced. This clarification focusing on principal and interest would produce a direct comparison of what the veteran is truly required to pay as between the two loans, regardless of externalities that may vary case-to-case, making the cost of the refinancing transaction more transparent to veterans. Therefore, VA interprets section 3709(a)(3) as requiring a comparison between that which the veteran pays for principal and interest under the loan being refinanced and that which the veteran would pay for principal and interest under the IRRRL.

By limiting the recoupment denominator to comparisons of the veteran’s monthly payments for principal and interest, the proposal would satisfy section 3709’s requirement to exclude taxes, amounts held in escrow, and fees paid under chapter 37. 38 U.S.C. 3709(a)(3). VA would clarify, however, that due to industry confusion regarding fees paid under chapter 37, the chapter 37 fees to be excluded from calculation under subsection (a)(3) are limited to fees that are charged monthly.

VA appreciates there could be other interpretations. For example, VA sees some merit in the suggestion that subsection (a)’s parentheticals are categorical exclusions, excluding VA’s funding fee from every aspect of the recoupment

calculation. The rationale would be that the parentheticals in both paragraphs (1) and (3) of section 3709(a) are phrased identically and provide that “fees paid under [chapter 37]” should not be included in the recoupment. The funding fee is required under 38 U.S.C. 3729, which makes it a fee paid under chapter 37 and therefore, necessarily excluded. Additionally, that interpretation would, in one way, seem consistent with VA’s approach to providing a harmonious, singular recoupment standard. Since VA is proposing to interpret paragraph (1) to exclude wholly the funding fee, VA could also propose to interpret paragraph (3) the same way.

VA agrees to some extent but disagrees with the outcome. Although VA would agree that VA must exclude from both the numerator and the denominator fees paid under chapter 37, VA does not believe the exclusion of fees paid under chapter 37 extends to every attenuated impact. If VA were to apply section 3709 in this manner, VA would have to exclude from the calculation any increase to the principal and interest of a monthly payment if such an increase was related in some way to a fee paid under chapter 37. To do so could pose a significant concern for veterans and would not be the most logical interpretation of the text.

In cases where veterans finance the funding fee by including it in one or both subject loans, veterans could not, as the statute could be read to require, simply rely on the difference between their pre-IRRRL monthly payments and IRRRL monthly payments to know whether the IRRRL would be in their financial interest. Instead, they would have to rely on the lender to correctly calculate an artificial month-to-month payment for both the loan being refinanced and the IRRRL to determine whether there are any savings. The denominator would be artificial because both payments—the payment used for principal and interest under the loan being refinanced and such payment used for the IRRRL—would

not correspond to a real payment. Instead, lenders would need to reverse-engineer a monthly payment for each loan by subtracting out the funding fee and re-amortizing the artificial principal balance, to contrive a non-existent payment solely for the purposes of recoupment.

Such artificiality is unnecessary under the text of the statute. VA does not believe that subsection (a)(3) requires lenders to construct non-existent payments, especially as measurements of the veteran's month-to-month savings as part of an anti-predatory scheme. Moreover, VA does not believe that the text requires veterans to rely on artificial payment amounts, rather than the actual amount the veteran will need to pay each month for principal and interest, to determine how the IRRRL affects the veteran from a financial perspective.

VA instead interprets the text of each parenthetical—both subsection (a)(1) and (a)(3)—as explained above, on its face and as elements of a harmonious whole, one that treats subsections (a)(1) and (a)(3) consistently but addresses different elements. Both paragraphs (1) and (3) exclude fees paid under chapter 37. But paragraph (3) further delimits its application, making it applicable to “regular monthly payments”, meaning any fees paid under chapter 37 monthly.

When a veteran closes a refinance transaction and pays a funding fee under section 3729, the charge is made at the closing table as a one-time collection. Either the veteran pays the fee in cash and the lender remits it to the Secretary, or the lender advances the fee on behalf of the veteran, remits the fee to the Secretary, and adds the advance to the principal loan amount. Regardless of the choice, the fee is collected and remitted to the Secretary, not to the lender. Otherwise, there could not be a guaranteed loan. See 38 U.S.C. 3729 (“No such



loan may be guaranteed, insured, made, or assumed until the fee payable under this section has been remitted to the Secretary.”).

But the funding fee required under section 3729 is not a fee on top of a regular monthly payment. VA’s funding fee is not like private mortgage insurance, for instance, which in other programs is a separate and distinct charge that must be added to the monthly payment of principal and interest and paid monthly over the course of the loan repayment period. If Congress or VA were to introduce such a monthly fee under chapter 37, one that a veteran and lender would need to add to the veteran’s regular monthly payments, VA would be required to exclude it from the recoupment calculation. Indeed, VA is proposing that such fees paid under chapter 37 must be excluded from the recoupment numerator and denominator.

Nevertheless, to say that subsection (a)(3)’s parenthetical exclusion would apply to every attenuated impact arising from fees paid under chapter 37 would go too far. When taken to its logical end, it could, in addition to necessitating the reverse engineering of artificial payments described above, largely undermine the recoupment standard. For instance, VA has in 38 CFR 36.4307 and 36.4313 outlined charges that may be made against and paid by a veteran in conjunction with an IRRRL. If a veteran were to finance all the veteran’s closing costs of an IRRRL, VA would include those costs in the recoupment calculation. If, however, VA were to interpret subsection (a)(3)’s parenthetical exclusion to apply to every attenuated impact arising from charges paid under chapter 37, all VA-approved charges could be construed as having been “paid under” chapter 37 for the purposes of section 3709(a)(3) because chapter 37 is the primary source of statutory authority for the VA-guaranteed loan program. In other words, if the fee is paid under the express or tacit authority of the organic, enabling legislation,

such fee would be paid under the auspices of chapter 37 and could fit within a narrow construction of subsection (a)(3). Any fee, closing cost, or expense that was financed would have to be backed out of the monthly payment and excluded from the recoupment calculation. This would require an artificial payment even further from the reality of the veteran's experience; and because all charges would be excluded, would undermine the purpose of section 3709(a).

VA's focus on the "calculation" of "lower regular monthly payments...as a result of the refinanced loan", shows a natural progression in the context of subsection (a) as a whole, consistent with VA's proposed recoupment formula. First, subsection (a)(1), requires a complete tallying of transaction costs for a tailored anti-predatory scheme. Second, subsection (a)(2) establishes the target for the recoupment period (36 months). Third, subsection (a)(3) establishes that the critical link between the two is the easiest, most straightforward way one might be able to compare the veteran's before-and-after financial situation, that is, the actual difference between the veteran's "regular monthly payments...as a result of the refinanced loan". See 38 U.S.C. 3709(a)(3). In sum, VA's proposed interpretation is to exclude the items named by the parenthetical, that is, "taxes, amounts held in escrow, and fees paid under this chapter", provided the veteran is making payments for such items that are separate and apart from the veteran's payments toward principal and interest. *Id.*

VA also notes that an interpretation requiring veterans, lenders, servicers, and other stakeholders to understand and execute an artificial month-to-month savings would make it more difficult for VA to administer a compliance program. VA believes, based on its oversight expertise, that the straightforward and transparent recoupment standard outlined in this proposed rule notice would further VA's ability to protect veterans from predatory lending practices. Using the

actual and true monthly principal and interest amounts for the denominator would be less confusing for veterans, lenders, and consumer advocates. The ability for stakeholders to rely on the monthly principal and interest amounts that are shown on standard loan documents would enable all parties, especially veterans, to understand the costs and calculate the recoupment period of the refinancing loan. Similarly, it is important for lenders to have confidence in their ability to calculate recoupment correctly, because passing recoupment is a prerequisite of VA's guaranty. See 38 U.S.C. 3709(a) (refinance loan "may not be guaranteed" unless recoupment standard is met). In VA's experience, the more difficult it is to understand how to ensure a good outcome, the more likely it is that lenders would be prone to shy away from the loan product. Ultimately, such a confusing paradigm would produce negative results for veterans, despite Congress having provided statutory language that could avoid such results. VA therefore proposes a recoupment standard that avoids contrived and artificial calculations and provides for a simple and direct comparison of the veteran's actual payments for principal and interest.

### 3. Additional Recoupment Matters

In proposed paragraph (a)(8)(v), VA would clarify that if the dollar amount of the veteran's monthly payment for principal and interest under the IRRRL is equal to or greater than the dollar amount of the veteran's monthly payment for principal and interest under the loan being refinanced, meaning there is no reduction in the monthly payment for principal and interest as a result of the IRRRL, the lender must not charge any fees, closing costs, or expenses, except for those enumerated by paragraphs (a)(8)(iii)(A), (a)(8)(iii)(B), and (a)(8)(iii)(C). Proposed paragraph (a)(8)(v) addresses those instances where the veteran chooses to realize the savings of an IRRRL by shortening the repayment term

(for example, the veteran moves from 30-year repayment term to 15-year repayment term), which may cause an increase in the monthly principal and interest payment. For such IRRRLs, veterans can realize significant savings by reducing the amount of interest paid and the number of months during which veterans must make loan payments, even though there is an increase or perhaps no change in the dollar amount of the monthly principal and interest payment as between the two subject loans.

Lenders offer such “zero-cost” refinance loans for several reasons. For example, lenders might offer such loans in recognition of a veteran’s loyalty to the lender or to attract veterans as new customers. VA has not made a practice of prohibiting “zero-cost” IRRRLs because, as discussed above, veterans can often realize significant savings in such transactions. Given the prospect of significant savings for veterans, VA proposes to continue allowing the practice of “zero-cost” IRRRLs under this rulemaking.

While veterans can realize significant savings under “zero-cost” IRRRLs, in the context of fee recoupment under 38 U.S.C. 3709(a), the plain text states that “all of the fees and incurred costs” must be recouped “through lower regular monthly payments.” In other words, the plain text commands that without a reduction in the dollar amount owed for monthly payments, that is, a recoupment denominator greater than zero, the recoupment standard cannot be met unless the recoupment numerator is zero.

An alternative, albeit untenable, reading of subsection (a)(3) could be that “lower regular monthly payments” might refer to the fact that, in repayment term reduction scenarios discussed above, veterans would have a smaller, that is, “lower,” number of monthly payments to make as a result of the refinancing loan (for example, from 300 payments to 180 payments). VA believes such an

interpretation is not feasible because it does not fit within the mathematical recoupment formula set forth by subsection (a). Without computing a fraction under the statutory scheme, VA would be unable to determine whether “all of the fees and incurred costs” would be recouped within “36 months”, even in cases where the refinance loan reduced the number of monthly payments. 38 U.S.C. 3709(a). Additionally, such an interpretation would render subsection (a)(3)’s parenthetical, which excludes certain taxes, escrows, and fees from the recoupment denominator, superfluous and incompatible with the remaining statutory text because such exclusions are irrelevant to whether there has been a reduction in the number of monthly payments. See *Republic of Sudan v. Harrison*, 139 S. Ct. 1048, 1058 (2019) (holding that courts must be hesitant to adopt statutory interpretations that render “superfluous another portion of that same law” (internal quotations omitted)). In other words, if paragraph (a)(3)’s element of the recoupment formula could be satisfied by virtue of a reduced number of monthly payments, it is unclear why the parenthetical would be necessary to establish that the number of required payments for taxes, escrows, and fees should be ignored or excluded. It is universally understood that property taxes continue even after a housing loan is satisfied. Additionally, loan servicers would not maintain escrow accounts after the loan is satisfied. VA’s proposed interpretation ascribes meaning to the entire statutory provision and fits with VA’s mathematical approach to the recoupment fraction, as described in this notice.

#### *B. Loan Seasoning (38 CFR 36.4307(a)(9))*

VA proposes to add a new paragraph (a)(9) to clarify loan seasoning standards for IRRRLs. Loan seasoning refers to the age of the loan being refinanced. If the loan being refinanced is not properly seasoned on or before the

note date of the refinancing loan, VA cannot guarantee the loan. See 38 U.S.C. 3709(c).

In proposed paragraph (a)(9)(i), VA would clarify that the refinancing loan must meet two primary statutory seasoning elements, as described below.

1. Seasoning Element One: Six Consecutive Monthly Payments

In proposed paragraph (a)(9)(i)(A), VA would describe the first statutory seasoning element that must be met, that is, that on or before the note date of the refinancing loan, the veteran must have made at least six consecutive monthly payments on the loan being refinanced. VA also proposes to clarify in this paragraph that a “monthly payment” for IRRRL seasoning purposes is the full monthly dollar amount owed under the note plus any additional monthly amounts agreed to between the veteran and the holder of the loan being refinanced, such as payments for taxes, hazard insurance, fees and charges related to late payments, and amounts owed as part of a repayment plan. Additionally, VA proposes to clarify that a “monthly payment” will count toward the requisite six consecutive monthly payments only if made in or before the same calendar month for which it is due. VA also proposes that a prepaid monthly payment will count toward the requisite six consecutive monthly payments, provided that the holder of the loan being refinanced applies such payment as satisfying the veteran’s obligation of payment for a specific month, advances the due date of the veteran’s next monthly payment, and does not apply the payment solely toward principal. VA would also explain that when multiple partial payments sum to the amount owed for one monthly payment, they will count as a single monthly payment toward the requisite six consecutive monthly payments, but only if all partial payments are made in or before the same calendar month for which full payment is due.

VA notes that 38 U.S.C. 3709(c) does not expressly state the requisite six consecutive monthly payments must immediately precede the refinancing loan. A missed payment after reaching the six-payment-threshold does not start a new seasoning period. To illustrate: a veteran makes six consecutive monthly payments and meets the seasoning requirement. The veteran is later hospitalized and misses payments eight and nine. The veteran applies for an IRRRL, which would allow the veteran to catch up on payments, and the savings provided by a lower payment would help the veteran better afford other credit obligations, including those from the hospitalization. VA would view this veteran's loan as having met the seasoning period. To view it otherwise would prevent the use of an IRRRL as a de facto home retention option.

IRRRLs provide many veterans a viable path to home retention when faced with financial difficulties. This was especially evident during the early stages of the COVID-19 pandemic, where many veterans took advantage of historically low interest rates and obtained IRRRLs to reduce their monthly housing loan payments. Many such veterans had never missed a payment before the pandemic. VA believes that a requirement that the six consecutive monthly payments must immediately precede the making of an IRRRL would not prevent predatory loan practices but would create unnecessary barriers to home retention.

VA believes that, rather than barring such veterans from receiving an IRRRL, the text of section 3709(c) allows for the requisite six consecutive monthly payments to be made at any point during the repayment term of the loan being refinanced. Regardless of whether a loan is in default, if the loan was seasoned before the default, the loan can satisfy the first element of the seasoning standard. If there is a break in monthly payments before six

consecutive payments are made, the count would reset to zero. Additionally, if a veteran continues to make monthly payments during a forbearance, such payments would count toward the requisite six consecutive monthly payments. However, if a veteran did not make a payment during the forbearance, the count would reset to zero.

Regarding what constitutes a “monthly payment”, VA believes the proposed definition would account for the various ways in which a veteran may remit a monthly loan payment, while making it clear that a mere partial payment, alone, cannot count toward the requisite six consecutive monthly payments. Thus, VA’s proposed definition would allow for cases where, for example, a veteran remits a partial payment to a lender (perhaps inadvertently) and then remits any outstanding amounts in or before the same calendar month for which the full payment is due. In the case of prepayment of certain amounts (for example, where a veteran arranges with the holder to make payments biweekly or on a quarterly or semi-annual basis), VA proposes such payments will count toward the requisite six consecutive monthly payments, provided that the payments actually correspond to and satisfy specific and particular monthly obligations, as described above.

Finally, considering the effects of the COVID-19 pandemic on veterans’ ability to meet housing loan payments, VA seeks public feedback on the impact of VA’s proposal to require that amounts owed as part of a repayment plan be included in the “monthly payment” definition for loan seasoning purposes. VA is interested in comments that could lead to alternative approaches.

## 2. Seasoning Element Two: 210 Days After the First Payment Due Date

In proposed paragraph (a)(9)(i)(B) VA would describe the second statutory seasoning element that must be met, which is that the note date of the IRRRL



must be a date that is not less than 210 days after the first payment due date of the loan being refinanced, regardless of whether the loan being refinanced became delinquent. VA would also state that the first payment due date of the loan being refinanced is not included in the 210-day count. Additionally, the note date of the IRRRL would be included in the 210-day count. For example, if the first payment due date of the loan being refinanced is June 1, 2020, day 1 would be June 2, 2020, and day 210 would be December 28, 2020. The IRRRL note could be dated on or after December 28.

VA also proposes to include language in paragraph (a)(9)(i)(B) to clarify that the 210-day period includes days when the veteran's loan is delinquent. Where the consecutive payment requirement hinges on dates payments are made, the 210-day requirement hinges on the date the first payment is due. Therefore, any period in which the veteran is not making payments on the loan (a situation that could affect the consecutive monthly payment count) would not affect the 210-day count. In other words, VA would require lenders to calculate the 210-day period based upon the first payment due date of the loan being refinanced, regardless of delinquency, except in cases of loan modifications and assumptions as described below. This is because VA interprets the first element of the seasoning requirement to be specific to timeliness of payments and the 210-day requirement to be specific to the overall time that must elapse.

### 3. Seasoning Elements 1 and 2: Loan Modifications and Assumptions

Section 3709(b) does not mention loan modifications or loan assumptions in the context of loan seasoning. There is no explicit direction on how to determine whether the borrower has paid six consecutive monthly payments or satisfied the 210-day requirement.

To provide clarity, VA is proposing in paragraph (a)(9)(ii) that if the loan being refinanced has been modified, any payment made before the modification date does not count toward the requisite six consecutive monthly payments under paragraph (a)(9)(i)(A). Additionally, the note date of the IRRRL must be a date that is not less than 210 days after the first payment due date of the modified loan. In other words, when the IRRRL is preceded by a loan modification, a process that generally results in an adjustment of the monthly payment and a re-pooling of the loan on the secondary market, the veteran must make six consecutive monthly payments under the loan modification. Additionally, the 210-day count would reset upon the date of loan modification. The first payment due date of the modified loan would not be included in the 210-day count. The note date of the refinancing loan would be included in the 210-day count.

Similarly, VA proposes to clarify in paragraph (a)(9)(iii) that if the loan being refinanced was assumed pursuant to 38 U.S.C. 3714, any payment made before the assumption date would not count toward the requisite six consecutive monthly payments under paragraph (a)(9)(i)(A). VA would also state that the note date of the IRRRL must be a date that is not less than 210 days after the first payment due date of the assumed loan. VA would clarify that the first payment due date of the assumed loan is not included in the 210-day count. The note date of the IRRRL would be included in the 210-day count.

In proposing this clarification for loan modifications and assumptions, VA interprets 38 U.S.C. 3709(c) as resetting the loan seasoning count following a fundamental change in the contractual terms of the loan. In other words, if the loan was modified or assumed, the borrower would need to make six consecutive monthly payments after the loan modification or assumption to meet loan

seasoning. Additionally, the note date of the IRRRL would need to be not less than 210 days after the first payment due date of the modified or assumed loan.

VA believes both proposed clarifications are grounded in the statutory text of section 3709(c), even if the statute does not mention them explicitly. In the case of a loan modification, a veteran and loan holder agree to a fundamental contractual alteration of the loan, where the dollar amount owed for monthly payments and the number of monthly payments necessary to satisfy the loan change, effectively resetting the expectations among veteran, lender, and secondary markets (such as markets for Government National Mortgage Association pools). Through these fundamental alterations, the veteran is required to initiate repayment on a new “first payment due date” of the modified loan. 38 U.S.C. 3709(c)(2). In the case of an assumption, a new borrower is agreeing to be bound by the terms of an existing housing loan contract. Under the plain text of the statute, “the borrower” of the loan being refinanced must make “at least six consecutive monthly payments on the loan being refinanced.” 38 U.S.C. 3709(c)(1). (emphasis added). The previous borrower’s payment history is not the new borrower’s and, therefore, is not attributable to the new borrower. This means that the loan would not be properly seasoned until the subject borrower, that is, the new borrower under the assumption, has made the requisite six consecutive monthly payments.

*C. Net Tangible Benefit (38 CFR 36.4307(a)(10) and (11))*

VA proposes to add new paragraphs (a)(10) and (11) to clarify statutory net tangible benefit (NTB) requirements under 38 U.S.C. 3709(b). In the home loan financing industry, NTB generally refers to the advantage a borrower gains by refinancing. Congress specified in section 3709(b)(1) that, as a prerequisite of VA’s guaranty, lenders must provide a veteran with an NTB test. 38 U.S.C.

3709(b)(1). Congress required the test but did not define its parameters. Thus, VA is proposing to provide the parameters, as described later in this notice.

Also, Congress provided more specific NTB criteria requiring minimum interest rate reductions for certain types of IRRRLs. As noted in VA's cash-out IFR notice, VA considered whether the NTB test described in subsection (b)(1) was introductory to the criteria set forth in subsections (b)(2) through (b)(4). See *Revisions to VA-Guaranteed or Insured Cash-Out Home Refinance Loans*, 83 FR 64459, 64460 (Dec. 17, 2018). VA concluded, however, that paragraphs (2) through (4) did not, in fact, comprise the totality of the NTB test, but instead imposed separate requirements in addition to the paragraph (1) requirement. *Id.* As discussed in the IFR notice, Congress, in setting these additional thresholds, addressed the risky aspects of moving from one type of interest rate to another and imposed differing parameters depending on the veteran's interest rate decision (that is, a fixed-rate or an adjustable rate). *Id.* at 64461.

#### 1. Interest Rate Requirements

VA proposes to restate the specific interest rate requirements described in sections 3709(b)(2) through 3709(b)(4) in new paragraph (a)(10) of § 36.4307. VA also proposes to interpret section 3709(b)(2) through 3709(b)(4) according to the same rationale that VA described for cash-out refinances, that is, paragraph (4) discount point requirements apply only in the cases where paragraph (3) applies. See *id.* at 64460-64462 (explaining that subsection (b)'s structure, sequence, and coherent scheme supports such an interpretation).

In proposed paragraph (a)(10)(i), VA would state that for cases in which the loan being refinanced has a fixed interest rate and the IRRRL will also have a fixed interest rate, the interest rate on the IRRRL must not be less than 50 basis points less than the loan being refinanced. See 38 U.S.C. 3709(b)(2). In

proposed paragraph (a)(10)(ii), VA would state that, in a case in which the loan being refinanced has a fixed interest rate and the IRRRL will have an adjustable rate (ARM), the interest rate on the IRRRL must not be less than 200 basis points less than the interest rate on the loan being refinanced. In addition, for fixed-to-ARM IRRRLs, discount points may be included in the IRRRL amount only if: (A) the lower interest rate is not produced solely from discount points; (B) the lower interest rate is produced solely from discount points, discount points equal to or less than one discount point are added to the loan amount, and the resulting loan balance (inclusive of all fees, closing costs, and expenses that have been financed) maintains a loan to value (LTV) ratio of 100 percent or less; or (C) the lower interest rate is produced solely from discount points, more than one discount point is added to the loan amount, and the resulting loan balance (inclusive of all fees, closing costs, and expenses that have been financed) maintains a loan to value ratio of 90 percent or less. VA also proposes to add a new paragraph (a)(10)(iii) to remind lenders that, under existing paragraph (a)(4)(i), no more than two discount points may be added to the loan amount.

In determining whether a loan must comply with one of the LTV ratios in proposed paragraph (a)(10)(ii), a lender must determine whether the lower interest of the IRRRL is produced solely from discount points. See 38 U.S.C. 3709(b)(4). The interest rate offered to a veteran is specific to each case and is based on several factors, including the type of loan and the overall mortgage market (for example, the interest rate environment). See *What are (discount) points and lender credits and how do they work?*, Consumer Financial Protection Bureau (Sept. 4, 2020), <https://www.consumerfinance.gov/ask-cfpb/what-are-discount-points-and-lender-credits-and-how-do-they-work-en-136>. Veterans can “buy down” the interest rate on a particular loan by purchasing discount points,

which are expressed as a percentage of the loan amount (that is, one discount point equals one percent of the loan amount). *Id.* See also 38 U.S.C. 3703(c). In the context of sections 3709(b)(3) and 3709(b)(4), this would mean that the lender must determine whether the requisite 200 basis point (two percent) interest rate reduction was met solely by virtue of the veteran's purchase of discount points. If the lender concludes that the veteran would not be offered the requisite interest rate reduction absent the veteran's purchase of discount points, then certain additional requirements would apply under proposed paragraphs (a)(10)(ii)(B) and (a)(10)(ii)(C).

VA observes that information to support whether a lower interest rate is produced solely from discount points is not widely available. While one discount point typically lowers the rate by 25 basis points, lenders have their own pricing structure (often referred to as lender pricing or rate sheets). The rate a lender might offer without discount points is generally not publicly accessible, and the rate can change due to factors such as daily market conditions, borrower risk factors, and corporate strategy. If VA does not have access to, for example, the lender's rate sheet, it can be difficult for VA to determine whether a lender has complied with certain discount point requirements. To avoid this issue, VA proposes a new paragraph (a)(10)(iv) requiring, in cases where the lender determines that the lower interest rate is not produced solely from discount points, that lenders provide VA with evidence to support such determination. VA believes that this approach will help shield veterans from predatory lending practices, while saving lenders from the burden of providing evidence in cases where the requisite interest rate reduction is produced solely from discount points.

The text of section 3709(b) implies some degree of risk of predatory lending inherent to veterans refinancing from a fixed interest rate to an adjustable interest rate, specifically when veterans finance the interest rate buy down by including discount points in the IRRRL. VA notes that § 36.4307(a)(4)(i) currently prohibits veterans from financing more than two discount points, meaning that veterans would still likely need to pay cash for some amount of discount points in the event of a 200-basis point reduction where the interest rate is achieved solely through discount points. Regardless, since appraisals of the home are not generally required for IRRRLs, veterans who refinance from a fixed rate to an adjustable rate, obtain a 200-basis point reduction solely through the purchase of discount points, and finance up to two discount points through the loan could be at risk of extending their liability beyond the value of their home.

VA's proposal to require lenders to provide evidence that the subject lower interest rates are not produced solely from discount points will help shed light on whether there is a true NTB to the veteran over the life of IRRRL. In cases where a veteran finances discount points on a fixed-to-ARM IRRRL, the lender would be required to show either that some portion of the veteran's lower interest rate was due, for example, to the lender's pricing structure (meaning discount points were not solely responsible for the lower rate) or that the financing of discount points would not exceed section 3709's cap on LTV ratios (90 or 100 percent, depending on the number of discount points financed).

Under this proposed regulatory standard, VA notes that lenders would only be required to provide VA with evidence that the subject interest rate reduction was not solely due to discount points in cases where the veteran finances discount points. Section 3709(b) does not impose an inquiry into whether the reduced interest rate is solely due to such points when a veteran

pays for all discount points using cash (likely at closing). Therefore, VA would not require evidence from the lender in such cases. In proposed paragraph (a)(10)(iv), VA would state that, in cases where the lower interest rate is not produced solely from discount points, as described by paragraph (a)(10)(ii)(A), lenders must provide to the Secretary evidence that the lower interest rate is not produced solely from discount points.

VA notes that section 3709(b) does not specify how lenders are to determine the requisite LTV ratios for NTB purposes. In 2019, VA clarified that a new appraisal would be necessary to determine such LTV ratios, but that the appraisals need not be ordered through VA's appraisal request system and need not be performed by a VA fee panel appraiser. See VA Circular 26-19-22, *Clarification and Updates to Policy Guidance for VA Interest Rate Reduction Refinance Loans (IRRRLs)* (Aug. 8, 2019), [https://www.benefits.va.gov/HOMELOANS/documents/circulars/26\\_19\\_22.pdf](https://www.benefits.va.gov/HOMELOANS/documents/circulars/26_19_22.pdf); see also VA Circular 26-19-22, Change 1, *Clarification and Updates to Policy Guidance for VA Interest Rate Reduction Refinance Loans (IRRRLs)* (July 24, 2020), [https://www.benefits.va.gov/HOMELOANS/documents/circulars/26\\_19\\_22\\_Change1.pdf](https://www.benefits.va.gov/HOMELOANS/documents/circulars/26_19_22_Change1.pdf). VA also stated that lenders may only charge veterans a reasonable and customary amount for the appraisal. *Id.* Finally, VA listed acceptable types of appraisal reports to determine property value for purposes of calculating the LTV ratio, providing lenders with flexibility to use less expensive valuation methods than those used to determine the reasonable value of a property. *Id.*

In this notice, VA proposes a new paragraph (a)(10)(v) to require lenders to use a property valuation from an appraisal report, completed no earlier than 180 days before the note date, as the dollar amount for the value in the loan to



value ratio described by paragraph (a)(10)(ii). VA would also require that the appraisal report must be completed by a licensed appraiser and the appraiser's license must be active at the time the appraisal report is completed. VA would also state that a veteran may only be charged for one such appraisal report and that a veteran may only be charged for such appraisal report as part of the flat charge not exceeding 1 percent of the amount of the loan, as described by § 36.4313(d)(2). Under this proposed standard, VA would continue to accept appraisal reports in the formats listed by VA Circular 26-19-22 and would provide notice to lenders of any updates to the list.

While VA proposes to require lenders to use a property valuation from an appraisal report as the dollar amount for the value in the LTV ratio, as mentioned above, lenders would not be required to use VA's appraisal request system to obtain the appraisal. Rather, VA proposes that lenders use their own appraisal management and assignment process to fulfill this requirement, unless directed by VA.

VA believes it would not be an effective use of government resources to require a VA fee panel appraisal in these LTV ratio determinations. VA fee panel appraisals are used to determine the reasonable value of a property, which helps protect VA from undue risk under the guaranty. Such appraisals also contribute toward determining VA's maximum guaranty amounts and can help VA understand whether certain minimum property and construction requirements are satisfied. See 38 U.S.C. 3710 and 3731; see also 38 CFR 36.4339 and 36.4351. Under 38 U.S.C. 3710(b)(8), an IRRRL's total loan amount is not subject to a maximum limit based upon the reasonable value of the property. See also 38 CFR 36.4339(a)(2). In other words, IRRRLs are not subject to the general requirement for VA-guaranteed loans that the loan not exceed 100 percent of the

reasonable value of the property. Additionally, since IRRRLs can only refinance existing VA-guaranteed loans, VA presumes, absent evidence to the contrary, that the subject property still meets minimum property and construction requirements because such requirements applied at the time the loan being refinanced was closed. Without the need to evaluate the property for these specific concerns, VA believes it would not be prudent to apply a requirement of a VA fee panel appraiser in the NTB context, due to potential elevated costs and burdens.

While VA believes this proposed approach for determining valuation for this select set of fixed-to-ARM IRRRL scenarios is the most reasonable and appropriate method, VA is interested in feedback regarding the advantages, if any, of using an alternative appraisal method.

## 2. Net Tangible Benefit Test

In VA's cash-out refinance IFR, VA explained that section 3709(b)'s NTB test is a test that must be passed. See Revisions to VA-Guaranteed or Insured Cash-Out Home Refinance Loans, 83 FR 64459, 64462 (Dec. 17, 2018). VA further elaborated that Congress, through section 3709(b), "imposed a requirement to establish the fitness of the loan, as opposed to a requirement only to disclose the characteristics of the loan for the veteran's understanding." *Id.* Under the same rationale, VA proposes to define the parameters of the NTB test for IRRRLs, which like the NTB test for cash-outs, would include requirements as to the loan's fitness and disclosure requirements to help veterans understand the financial implications of the refinance transaction. VA proposes to set forth the NTB test requirements in a new paragraph (a)(11) of § 36.4307. More specifically, VA proposes to clarify in introductory text in paragraph (a)(11) that the refinancing loan must provide an NTB to the veteran. VA would also state

that, for purposes of § 36.4307, NTB means that the refinancing loan is in the financial interest of the veteran, that the lender of the refinancing loan must provide the veteran with an NTB test, and that the NTB test must be satisfied.

In proposed paragraph (a)(11)(i), VA proposes to state that the IRRRL must meet the requirements prescribed by paragraphs (a)(8), (a)(9), and (a)(10). As described in this notice, such paragraphs set forth requirements for fee recoupment, loan seasoning, and interest rates, respectively. VA believes that an IRRRL that meets such requirements, given the safeguards imposed, will improve the veteran's financial position, meaning the loan will be in the veteran's financial interest.

In paragraph (a)(11)(ii), VA proposes to require lenders to provide veterans with an initial loan comparison disclosure and a final loan comparison disclosure of the following: the loan payoff amount of the IRRRL, with a comparison to the loan payoff amount of the loan being refinanced; the type of interest rate, whether a fixed-rate, traditional adjustable-rate, or hybrid adjustable-rate, with a comparison to the type of the loan being refinanced; the interest rate of the IRRRL, with a comparison to the current interest rate of the loan being refinanced; the term of the IRRRL, with a comparison to the term remaining on the loan being refinanced; and the dollar amount of the veteran's monthly payment for principal and interest under the IRRRL, with a comparison to the current dollar amount of the veteran's monthly payment for principal and interest under the loan being refinanced. Consistent with feedback received on VA's cash-out refinance IFR notice, VA proposes to require that lenders provide the subject information in a format prescribed by the Secretary, that is, via a new proposed form, *Interest Rate Reduction Refinancing Loan Comparison*

*Disclosure.* More information about this form is provided in the Paperwork Reduction Act section below.

Under new paragraph (a)(11)(iii), VA proposes to require that lenders provide the veteran with the IRRRL disclosures on at least two separate occasions. First, VA proposes to require that the lender provide the veteran with an initial loan comparison disclosure on the date the lender provides the Loan Estimate, required under 12 CFR 1026.19(e), to the veteran. Paragraph (a)(11)(iii) would also state that if the lender is required to provide to the veteran a revised Loan Estimate under 12 CFR 1026.19(e) that includes any of the revisions described by proposed paragraph (a)(11)(iv), the lender must provide to the veteran, on the same date the revised Loan Estimate must be provided, an updated loan comparison disclosure. Under proposed paragraph (a)(11)(iv), the enumerated revisions would be: a revision to any loan attribute that must be compared under proposed paragraph (a)(11)(ii); a revision that affects the recoupment under paragraph (a)(8); and any other revision that is a numeric, non-clerical change.

VA also proposes a new paragraph (a)(11)(v), which would require the lender to provide the veteran with a final loan comparison disclosure (in a format specified by the Secretary) on the date the lender provides to the veteran the Closing Disclosure required under 12 CFR 1026.19(f). Additionally, the veteran would need to certify, following receipt of the final loan comparison disclosure, that the veteran received the initial and final loan comparison disclosures required by proposed paragraph (a).

Finally, VA proposes to clarify in paragraph (a)(11)(vi), that regardless of whether the lender must provide the veteran with a Loan Estimate under 12 CFR 1026.19(e) or a Closing Disclosure under 12 CFR 1026.19(f), the lender must

provide the veteran with the initial and final loan comparison disclosures.

Proposed paragraph (a)(11)(vi) would also state that where the lender is not required to provide the veteran with a Loan Estimate or a Closing Disclosure because the IRRRL is an exempt transaction under 12 CFR 1026.3, the lender must provide the veteran with the initial and final comparison disclosures on the dates the lender would have been required to provide the veteran with the Loan Estimate under 12 CFR 1026.19(e) and the Closing Disclosure under 12 CFR 1026.19(f), respectively, as if the IRRRL was not an exempt transaction.

Requiring lenders to provide veterans with a comparison of the fundamental loan details described above, on two separate occasions, would help enable such veterans to better understand the IRRRL transaction and, consequently, make a sound financial decision. Further, providing the disclosures on the same dates that lenders, in most cases, would need to provide Loan Estimates and Closing Disclosures under Consumer Financial Protection Bureau (CFPB) rules, would reduce the likelihood of lender confusion regarding disclosure dates and save lenders from having to meet deadlines that are out of sync with such CFPB rules. As VA described in the cash-out IFR, these disclosures would help veterans “avoid costly mistakes that may strip their home equity or make it difficult to sell or refinance their home in the future.” See 83 FR at 64463.

*D. Conforming Amendments, Revisions for Consistency and Clarity, and Technical Corrections*

1. Fees Associated with IRRRL Appraisals

As mentioned above, VA proposes appraisal provisions in furtherance of the LTV ratio determinations required by 38 U.S.C. 3709. VA believes it is necessary to clarify in this rulemaking how lenders can account for the costs of

such IRRRL appraisal fees. Current VA policy states that lenders can include the cost of such appraisals as part of the flat charge authorized for VA-guaranteed loans. See 38 CFR 36.4313(d)(2) (“lender may charge...a flat charge not exceeding 1 percent of the amount of the loan...in lieu of all other charges relating to costs of origination not expressly specified”). Through this rulemaking, VA proposes to add a provision to 38 CFR 36.4313(d)(1)(i), and make necessary associated formatting revisions, to specify that any appraisal fee for a purpose specified in § 36.4307(a)(10) is not to be considered a fee that may be separately charged, but rather, should the lender choose to charge the fee to the veteran, is to be included in the one percent flat charge. For VA audit purposes, VA would expect that any appraisal report and invoice be included in the lender’s loan file.

## 2. Other Revisions

VA proposes the following non-substantive changes to § 36.4307. First, VA proposes to correct a reference error in paragraph (a)(4)(ii). Current paragraph (a)(4)(ii) incorrectly references § 36.4339(a)(4) as the source relating to financed energy efficient improvements. The correct reference is § 36.4339(b). Additionally, for ease of reading, VA proposes to insert paragraph headings in current § 36.4307(a)(4), (a)(5), (a)(6) and (a)(7); the headings being: “*Maximum Amount of Refinancing Loan.*”, “*Cases of Delinquency.*”, “*Guaranty Amount.*”, and “*Loan Term.*”, respectively.

Lastly, VA proposes a technical correction to § 36.4313(e)(1)(i) to clarify that the 0.50 percent funding fee applies to all IRRRLs. Specifically, VA proposes to replace the “and” in paragraph (e)(1)(i) with an “or”.

## **Executive Orders 12866 and 13563**

Executive Orders 12866 and 13563 direct agencies to assess the costs and benefits of available regulatory alternatives and, when regulation is

necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, and other advantages; distributive impacts; and equity). Executive Order 13563 (Improving Regulation and Regulatory Review) emphasizes the importance of quantifying both costs and benefits, reducing costs, harmonizing rules, and promoting flexibility. The Office of Information and Regulatory Affairs has determined that this rule is a significant regulatory action under Executive Order 12866. The Regulatory Impact Analysis associated with this rulemaking can be found as a supporting document at [www.regulations.gov](http://www.regulations.gov).

### **Regulatory Flexibility Act**

The Secretary hereby certifies that this proposed rule would not have a significant economic impact on a substantial number of small entities as they are defined in the Regulatory Flexibility Act (5 U.S.C. 601-612). To assess whether the proposed rule could be expected to have a “significant economic impact” on small entities, VA considers the annual costs and transfer payments of the rule for and from small entities compared to their annual revenue. As described in the impact analysis, this proposed rule and Pub. L. 115-174 (the 2018 Act) would affect lenders participating in VA’s home loan program.

VA was able to estimate the size of 1,073 of 1,202 active lenders that originated IRRRLs within the past three fiscal years using a combination of sources. VA relied on the size standards from the Small Business Administration (SBA)<sup>1</sup> and used data from Data Axle and Factiva (two business data providers) along with data from the Federal Deposit Insurance Corporation (FDIC) and the

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<sup>1</sup> U.S. Small Business Administration. (2019). *SBA Table of Size Standards*. [https://www.sba.gov/sites/default/files/2019-08/SBA%20Table%20of%20Size%20Standards\\_Effective%20Aug%2019%2C%202019\\_Rev.pdf](https://www.sba.gov/sites/default/files/2019-08/SBA%20Table%20of%20Size%20Standards_Effective%20Aug%2019%2C%202019_Rev.pdf).

National Credit Union Administration (NCUA).<sup>2</sup> Of the 1,073 lenders with sufficient data for VA to estimate their size, 598 (55.73%) are considered small. The average annual revenue of these 598 small lenders is estimated at \$23.65 million.<sup>3</sup>

VA compares this average annual revenue of the small lenders to the average annual costs that fall on the small lenders, as well as the annual transfer payments from small lenders to determine the economic significance of the 2018 Act and the proposed rule described by this notice on small entities. The costs of the proposed rule that fall on all lenders, including small lenders, would come from rule familiarization and those accounted for through PRA analysis (that is, information technology system alignment). The transfer payments of the 2018 Act from lenders, including small, would come from the reduction in annual payments from the interest rate reduction requirements and the reduction in refinance fees from the recoupment requirement. These reductions would represent transfer payments from lenders to veterans.

VA divides the one-time cost of rule familiarization and system alignments evenly across the 1,202 lenders. The costs of the one-time rule familiarization and system alignments in the first year of the rule are estimated at \$1,235 for each lender, including the small lenders. The reduction in annual payments and the reduction in closing costs range from \$78,463 to \$94,868 per small lender,

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<sup>2</sup> VA uses data from Data Axle and Factiva to determine the industry (as identified by the primary NAICS code) for the active VA home loan lenders. For industries where size standards are determined by annual revenue, VA compares the revenue of each lender in these industries as reported in Data Axle and Factiva to the SBA annual revenue threshold for small businesses. For industries where size standards are determined by assets, VA compares the relevant SBA threshold for small businesses to asset data from the FDIC for lenders with primary NAICS codes 522110 (Commercial Banking) and 522120 (Savings Institutions), and asset data from the NCUA for lenders with a primary NAICS code of 522130 (Credit Unions).

<sup>3</sup> VA averages the sales volumes from Data Axle and Factiva for all lenders considered small, including those primarily considered commercial banks, savings institutions, and credit unions.



depending on the year in the analysis period.<sup>4</sup> As shown in Table 1, adding these impacts results in the average estimated burden from \$79,678 to \$94,868 per small lender in the first and final years of the analysis period, respectively.

*Table 1: Average Burden on Small Lenders by Provision (2020 dollars)*

	<b>Provision</b>	<b>2023 (first year)</b>	<b>2032 (final year of analysis period)</b>
2018 Act	Reduction in Annual Payments	\$ 29,314	\$35,443
	Reduction in Refinance Fees	\$ 49,149	\$ 59,425
Proposed Rule	Rule Familiarization	\$101.66	\$0
	PRA System Alignment	\$1,133.06	\$0

The estimated burden of the 2018 Act and rule as a proportion of small lender revenue ranges from 0.337 percent to 0.401 percent, as displayed in Table 2. The burden on small lenders stemming from the 2018 Act would be significantly greater than the burden associated with the rule.

*Table 2: Annual Costs/Transfers and Revenue Per Affected Small Entity (000s of 2020 Dollars)*

<b>Year</b>	<b>2023 (first year)</b>	<b>2032 (final year of analysis period)</b>
Annual Burden of 2018 Act <b>A</b>	\$79	\$95

<sup>4</sup> VA scales the costs/transfers by first dividing the total average annual volume of IRRRLs guaranteed by small lenders in the past three full fiscal years (64,758) by the total average annual IRRRLs guaranteed in the same period by all lenders with enough information to classify their size (306,671). Multiplying that ratio (0.211) by the total costs and transfers that vary depending on lender size gives VA the total costs and transfers that fall on small lenders. Dividing the total costs and transfers that fall on small lenders by the total estimated number of small lenders (670, which is the percent of small lenders from the classified population (55.73%) multiplied by all IRRRL lenders (1,202)) provides the average annual cost and transfers for and from each small lender.

Annual Burden of the Proposed Rule <b>B</b>	\$1	\$0
Total Annual Burden <b>c = a + b</b>	\$80	\$95
Average Annual Revenue for Small Entities <b>D</b>	\$23,647	\$23,647
Burden of the 2018 Act as a Percentage of Annual Revenue <b>e = a / d</b>	0.337%	0.401%
Burden of the Proposed Rule as a Percentage of Annual Revenue <b>f = b / d</b>	0.005%	0%
Total Burden as a Percentage of Annual Revenue <b>g = c / d</b>	0.342%	0.401%

VA considers a rule to have a “significant economic impact” when the impact associated with the rule for a small entity equals or exceeds 1 percent of annual revenue. Thus, while the rule is expected to affect a substantial number of small entities (55.73 percent of active small IRRRL lenders), the burden would not be economically significant. On this basis, the Secretary certifies that the adoption of this proposed rule will not have a significant economic impact on a substantial number of small entities as defined in the Regulatory Flexibility Act.

### **Unfunded Mandates**

The Unfunded Mandates Reform Act of 1995 requires, at 2 U.S.C. 1532, that agencies prepare an assessment of anticipated costs and benefits before issuing any rule that may result in the expenditure by State, local, and tribal governments, in the aggregate, or by the private sector, of \$100 million or more

(adjusted annually for inflation) in any one year. This proposed rule would have no such effect on State, local, and tribal governments, or on the private sector.

### **Paperwork Reduction Act**

This proposed rule includes provisions constituting a revised collection of information under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501-3521) that require approval by the Office of Management and Budget (OMB). Accordingly, under 44 U.S.C. 3507(d), VA has submitted a copy of this rulemaking action to OMB for review and approval.

OMB assigns control numbers to collections of information it approves. VA may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number. If OMB does not approve the collection of information as requested, VA will immediately remove the provisions containing that collection of information or take such other action as is directed by OMB.

Comments on the revised collection of information contained in this rulemaking should be submitted through [www.regulations.gov](http://www.regulations.gov). Comments should indicate that they are submitted in response to “RIN 2900-AR58; Loan Guaranty: Revisions to VA-Guaranteed or Insured Interest Rate Reduction Refinancing Loans” and should be sent within 60 days of publication of this rulemaking. The collections of information associated with this rulemaking can be viewed at: [www.reginfo.gov/public/do/PRAMain](http://www.reginfo.gov/public/do/PRAMain).

OMB is required to make a decision concerning the collection of information contained in this rulemaking between 30 and 60 days after publication of this rulemaking in the Federal Register (FR). Therefore, a comment to OMB is best assured of having its full effect if OMB receives it

within 30 days of publication. This does not affect the deadline for the public to comment on the provisions of this rulemaking.

The Department considers comments by the public on a new collection of information in-

- Evaluating whether the new collections of information are necessary for the proper performance of the functions of the Department, including whether the information will have practical utility;
- Evaluating the accuracy of the Department's estimate of the burden of the new collection of information, including the validity of the methodology and assumptions used;
- Enhancing the quality, usefulness, and clarity of the information to be collected; and
- Minimizing the burden of the collection of information on those who are to respond, including through the use of appropriate automated, electronic, mechanical, or other technological collection techniques or other forms of information technology, for example, permitting electronic submission of responses.

The collection of information associated with this rulemaking contained in 38 CFR 36.4307 is described immediately following this paragraph, under its respective title.

Title: Interest Rate Reduction Refinancing Loans

OMB Control No: 2900-0386

CFR Provision: 38 CFR 36.4307

- *Summary of collection of information:* This information collection currently includes VA Form 26-8923, *IRRRL Worksheet*, certification by lenders regarding recoupment, net tangible benefit, and loan seasoning, and a

disclosure from lenders to veterans outlining recoupment and net tangible benefit. Through this proposed rulemaking, at proposed 38 CFR 36.4307(a)(11), VA would standardize the disclosure provided by lenders to veterans. Specifically, as proposed, lenders would be required to utilize a new standardized form, *Interest Rate Reduction Refinancing Loan Comparison Disclosure* (hereinafter, *Comparison Disclosure*), to notify veterans of certain loan information, including the total closing costs and recoupment period, at various stages during the loan process (initial, revised (as applicable), and final). As part of the proposed process, veterans would need to sign the final disclosure. Regarding the *IRRRL Worksheet*, VA is revising this form consistent with provisions of proposed 38 CFR 36.4307(a)(8) – (11) to collect information and certifications in one place. Generally, as explained below, VA already collects the subject information as part of the normal course of business. The proposed method of such collection should not increase stakeholders' burden for providing the information.

- *Description of need for information and proposed use of information:* VA would use the information on the *Comparison Disclosure* to ensure lender compliance with the comparison disclosure requirements, which would ensure that veterans can be fully apprised of the financial impact the refinancing transaction has on their loan terms, as part of meeting the NTB test. The *Comparison Disclosure* would standardize the information veterans are receiving and would make it easier for veterans to compare lenders' fees and charges. The standardized disclosure would also assist stakeholders in understanding whether the lender disclosed information for each requisite item. The information associated

with the *IRRRL Worksheet* would be used by VA to ensure that the IRRRL is made in the veteran's financial interest. The worksheet would provide evidence that the lender complied with recoupment, loan seasoning, and net tangible benefit requirements. The certification would further diminish the likelihood that veterans are subject to predatory loans.

- *Description of likely respondents:* The *Comparison Disclosure* and *IRRRL Worksheet* must be completed for each VA-guaranteed IRRRL. For each loan, lenders and veterans would review and complete the *Comparison Disclosure*. Lenders would complete the *IRRRL Worksheet*.
  - *Estimated number of respondents:* VA anticipates the estimated number of annual respondents to be 173,193. This number reflects a three-year average of VA's projected volume of IRRRLs for fiscal years 2023 through 2025.
  - *Estimated frequency of responses:* For the *Comparison Disclosure*, four times per loan for generating and disclosing the information to the veteran; one time per loan for the final disclosure signing by the veteran; and one time for the information technology system alignment. For the *IRRRL Worksheet*, typically a one-time collection per loan.
  - *Estimated average burden per response:* For the *Comparison Disclosure*, 10 minutes for loan officers (total for average of four instances of generation and disclosure); 5 minutes for the veteran per loan for the final disclosure. For the *IRRRL Worksheet*, 15 minutes for loan officers.
- While VA proposes to update the disclosure for an IRRRL into the standardized *Comparison Disclosure* and revise the *IRRRL Worksheet*, VA has assessed no incremental burden associated with this rulemaking

because: A) standardization of the disclosures would make it easier for lenders to comply with overall procedures that predate this proposed rule, and B) lenders can do so through technological means.

- *Estimated total annual reporting and recordkeeping burden:* VA anticipates no change in the total annual reporting and recordkeeping burden regarding this collection, which is currently estimated to be no burden hours. In that regard, VA's proposed revisions to this existing information collection, including standardization of the comparison disclosures, would merely standardize and adjust the documentation/information that lenders must provide to the veteran, the cost of which falls within customary and usual business practices.
- *Estimated cost to respondents per year:* VA estimates the annual cost to respondents to be \$3,060,038.<sup>5</sup> While VA notes that this represents a decrease from previous estimates, this is based on the revised volume estimates not associated with the rulemaking and not a change in the burden to respondents to comply with this information collection. Therefore, VA estimates no incremental annual burden cost to respondents as a result of this proposed rulemaking.
- VA also estimates a one-time system alignment cost associated with this information collection of \$1,361,943. To derive this estimate, VA generated a high/low estimate of the one-time technology costs associated with this information collection. The low estimate assumes that 80 percent of affected lending entities (that is, 962 of the 1,202 active VA

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<sup>5</sup> To estimate the total information collection burden cost, VA uses the 2020 Bureau of Labor Statistics (BLS) mean hourly wage of \$27.07 for "All Occupations" (veterans) and \$36.99 for "Loan Officers". This information is available at [https://www.bls.gov/oes/2020/may/oes\\_nat.htm](https://www.bls.gov/oes/2020/may/oes_nat.htm). VA is using 2020 BLS mean hourly wages for consistency with the regulatory impact analysis, which uses 2020 dollars for the base year estimate.

lenders that make IRRRLs) would not be required to complete any technology alignments as the software companies who supply their loan origination software (LOS) systems would update their products in time to enable these lenders to comply with the regulatory requirements. The costs therefore represent the costs to the remaining 20 percent of lenders (that is, 240 lenders) that would need to complete a technology alignment to enable them to generate the comparison disclosure in their LOS consistent with this information collection's standardized form. The high estimate assumes that no LOS company product updates would be in place on time and all 1,202 lenders would be required to assume the costs of completing a technology alignment to enable generating their disclosures.

VA calculated the one-time technology costs utilizing the amount of time estimated to develop a custom comparison disclosure form (either through existing LOS software or via a third-party contract). VA assumed 40 hours of planning, development, testing, and deployment to add the standardized disclosure to a lender's existing LOS. The wage burden was calculated as a composite wage, with weighting based on information provided by various industry professionals. Mean hourly wages from the 2020 BLS Occupational Employment and Wages data were used to estimate a composite wage as 5% Compliance Officer (occupation code 13-1041) at \$36.35/hour, 5% Lawyer (occupation code 23-1011) at \$71.59/hour, and 90% Computer Occupations (occupation code 15-1200) at \$46.46/hour, for a composite wage of \$47.21.<sup>6</sup>

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<sup>6</sup> The 2020 Bureau of Labor Statistics (BLS) mean hourly wages are available at [https://www.bls.gov/oes/2020/may/oes\\_nat.htm](https://www.bls.gov/oes/2020/may/oes_nat.htm).



**Assistance Listing**

The Assistance Listing number and title for the program affected by this document is 64.114, Veterans Housing—Guaranteed and Insured Loans.

**List of Subjects in 38 CFR Part 36**

Condominiums, Housing, Individuals with disabilities, Loan programs—housing and community development, Loan programs—veterans, Manufactured homes, Mortgage insurance, Reporting and recordkeeping requirements, Veterans.

**Signing Authority**

Denis McDonough, Secretary of Veterans Affairs, approved this document on September 14, 2022, and authorized the undersigned to sign and submit the document to the Office of the Federal Register for publication electronically as an official document of the Department of Veterans Affairs.

Luvenia Potts,  
Regulation Development Coordinator,  
Office of Regulation Policy & Management,  
Office of General Counsel,  
Department of Veterans Affairs.

For the reasons stated in the preamble, the Department of Veterans Affairs proposes to amend 38 CFR part 36 as set forth below:

## PART 36 — LOAN GUARANTY

### Subpart B — Guaranty or Insurance of Loans to Veterans With Electronic Reporting

1. The authority citation for part 36 continues to read as follows:

Authority: 38 U.S.C. 501 and 3720.

2. Amend § 36.4307 by:

- a. In paragraph (a)(4)(ii), removing the cross-reference to “§ 36.4339(a)(4)” and adding, in its place, the cross-reference “§ 36.4339(b)”;
- b. In paragraphs (a)(4), (5), (6), and (7), adding paragraph headings;
- c. Adding new paragraphs (a)(8), (9), (10), and (11); and
- d. Revising the authority citation at the end of the section.

The revisions and additions read as follows:

#### **36.4307 Interest rate reduction refinancing loan.**

(a) \* \* \*

\* \* \* \* \*

(4) *Maximum amount of refinancing loan.* \* \* \*

(5) *Cases of delinquency.* \* \* \*

(6) *Guaranty amount.* \* \* \*

(7) *Loan term.* \* \* \*

(8) *Recoupment.* (i) The lender of the refinancing loan must provide the Secretary with a certification that all fees, closing costs, and expenses (other than taxes, amounts held in escrow, and fees paid under 38 U.S.C. chapter 37) that would be incurred by the veteran as a result of the refinance are scheduled

to be recouped on or before the date that is 36 months after the note date of the refinancing loan.

(ii) The recoupment period is calculated by dividing the dollar amount equating to the sum of all fees, closing costs, and expenses, whether included in the loan or paid at or outside of closing, minus lender credits (the numerator), by the dollar amount by which the veteran's monthly payment for principal and interest is reduced as a result of the refinance (the denominator).

(iii) *Numerator.* The numerator described by paragraph (a)(8)(ii) of this section is the dollar amount equating to the sum of all fees, closing costs, and expenses that would be incurred by the veteran as a result of the refinance. Except as provided in this paragraph (a)(8)(iii), such sum includes any charge that is incurred by the veteran as a result of the refinance, including taxes that are not described in paragraph (a)(8)(iii)(C) of this section. Lender credits may be subtracted from other amounts in the numerator. The following items do not constitute fees, closing costs, or expenses for the purposes of this paragraph (a)(8)(iii) and are excluded from the numerator:

(A) The loan fee as prescribed by 38 U.S.C. 3729;

(B) Prepaid interest and amounts held in escrow (for example, amounts for hazard insurance); and

(C) Taxes and assessments on the property, even when paid outside of their normal schedule, that are not incurred solely due to the refinance transaction (for example, property taxes and special assessments).

(iv) *Denominator.* The denominator described by paragraph (a)(8)(ii) of this section is the dollar amount by which the veteran's monthly payment for principal and interest is reduced as a result of the refinance. The reduction is calculated by subtracting the veteran's monthly payment for principal and interest

under the refinancing loan from the veteran's monthly payment for principal and interest under the loan being refinanced. When calculating monthly payments for principal and interest, the lender must use the full payment, without omitting any amounts to be repaid monthly by the veteran and attributable to, for example, financed fees, financed loan fees prescribed by 38 U.S.C. 3729, financed closing costs, and financed expenses.

(v) If the dollar amount of the veteran's monthly payment for principal and interest under the refinancing loan is equal to or greater than the dollar amount of the veteran's monthly payment for principal and interest under the loan being refinanced, meaning there is no reduction in the monthly payment for principal and interest as a result of the refinancing loan, the lender must not charge any fees, closing costs, or expenses, except for those enumerated by paragraphs (a)(8)(iii)(A), (B), and (C) of this section.

(9) *Loan seasoning.* (i) The refinancing loan must meet both of the following requirements:

(A) On or before the note date of the refinancing loan, the veteran must have made at least six consecutive monthly payments on the loan being refinanced. For the purposes of this paragraph (a)(9), "monthly payment" means the full monthly dollar amount owed under the note plus any additional monthly amounts agreed to between the veteran and the holder of the loan being refinanced, such as payments for taxes, hazard insurance, fees and charges related to late payments, and amounts owed as part of a repayment plan. A monthly payment will count toward the requisite six consecutive monthly payments only if made in or before the same calendar month for which it is due. A prepaid monthly payment will count toward the requisite six consecutive monthly payments, provided that the holder of the loan being refinanced applies

such payment as satisfying the veteran's obligation of payment for a specific month, advances the due date of the veteran's next monthly payment, and does not apply the payment solely toward principal. When multiple partial payments sum to the amount owed for one monthly payment, they will count as a single monthly payment toward the requisite six consecutive monthly payments, but only if all partial payments are made in or before the same calendar month for which full payment is due.

(B) The note date of the refinancing loan must be a date that is not less than 210 days after the first payment due date of the loan being refinanced, regardless of whether the loan being refinanced became delinquent. The first payment due date of the loan being refinanced is not included in the 210-day count. The note date of the refinancing loan is included in the 210-day count.

(ii) *Loan modifications.* If the loan being refinanced has been modified, any payment made before the modification date does not count toward the requisite six consecutive monthly payments under paragraph (a)(9)(i)(A) of this section. The note date of the refinancing loan must be a date that is not less than 210 days after the first payment due date of the modified loan. The first payment due date of the modified loan is not included in the 210-day count. The note date of the refinancing loan is included in the 210-day count.

(iii) *Assumptions.* If the loan being refinanced was assumed pursuant to 38 U.S.C. 3714, any payment made before the assumption date does not count toward the requisite six consecutive monthly payments under paragraph (a)(9)(i)(A) of this section. The note date of the refinancing loan must be a date that is not less than 210 days after the first payment due date of the assumed loan. The first payment due date of the assumed loan is not included in the 210-day count. The note date of the refinancing loan is included in the 210-day count.

(10) *Interest rate.* (i) In a case in which the loan being refinanced has a fixed interest rate and the refinancing loan will also have a fixed interest rate, the interest rate on the refinancing loan must not be less than 50 basis points less than the interest rate on the loan being refinanced.

(ii) In a case in which the loan being refinanced has a fixed interest rate and the refinancing loan will have an adjustable rate, the interest rate on the refinancing loan must not be less than 200 basis points less than the interest rate on the loan being refinanced. In addition, discount points may be included in the loan amount only if—

(A) The lower interest rate is not produced solely from discount points;

(B) The lower interest rate is produced solely from discount points, discount points equal to or less than one discount point are added to the loan amount, and the resulting loan balance (inclusive of all fees, closing costs, and expenses that have been financed) maintains a loan to value ratio of 100 percent or less; or

(C) The lower interest rate is produced solely from discount points, more than one discount point is added to the loan amount, and the resulting loan balance (inclusive of all fees, closing costs, and expenses that have been financed) maintains a loan to value ratio of 90 percent or less.

(iii) Pursuant to paragraph (a)(4)(i) of this section, no more than two discount points may be added to the loan amount.

(iv) In cases where the lower interest rate is not produced solely from discount points, as described by paragraph (a)(10)(ii)(A) of this section, lenders must provide to the Secretary evidence that the lower interest rate is not produced solely from discount points.

(v) Lenders must use a property valuation from an appraisal report, completed no earlier than 180 days before the note date, as the dollar amount for the value in the loan to value ratio described by paragraph (a)(10)(ii) of this section. The appraisal report must be completed by a licensed appraiser and the appraiser's license must be active at the time the appraisal report is completed. A veteran may only be charged for one such appraisal report. A veteran may only be charged for such appraisal report as part of the flat charge not exceeding 1 percent of the amount of the loan, as described by § 36.4313(d)(2). While a lender may use a VA-designated fee appraiser to complete the appraisal report, lenders should not request an appraisal through VA systems unless directed by the Secretary.

(11) *Net tangible benefit.* The refinancing loan must provide a net tangible benefit to the veteran. For the purposes of this section, net tangible benefit means that the refinancing loan is in the financial interest of the veteran. The lender of the refinancing loan must provide the veteran with a net tangible benefit test. The net tangible benefit test must be satisfied. The net tangible benefit test is defined as follows:

(i) The refinancing loan must meet the requirements prescribed by paragraphs (a)(8), (9), and (10) of this section.

(ii) The lender must provide the veteran with an initial loan comparison disclosure and a final loan comparison disclosure of the following:

(A) The loan payoff amount of the refinancing loan, with a comparison to the loan payoff amount of the loan being refinanced;

(B) The type of the refinancing loan, whether a fixed-rate loan, traditional adjustable-rate loan, or hybrid adjustable-rate loan, with a comparison to the type of the loan being refinanced;

(C) The interest rate of the refinancing loan, with a comparison to the current interest rate of the loan being refinanced;

(D) The term of the refinancing loan, with a comparison to the term remaining on the loan being refinanced; and

(E) The dollar amount of the veteran's monthly payment for principal and interest under the refinancing loan, with a comparison to the current dollar amount of the veteran's monthly payment for principal and interest under the loan being refinanced.

(iii) The lender must provide the veteran with an initial loan comparison disclosure (in a format specified by the Secretary) on the date the lender provides the Loan Estimate, required under 12 CFR 1026.19(e), to the veteran. If the lender is required to provide to the veteran a revised Loan Estimate under 12 CFR 1026.19(e) that includes any of the revisions described by paragraph (a)(11)(iv) of this section, the lender must provide to the veteran, on the same date the revised Loan Estimate must be provided, an updated loan comparison disclosure.

(iv) The revisions described by this paragraph (a)(11)(iv) are:

(A) A revision to any loan attribute that must be compared pursuant to paragraph (a)(11)(ii) of this section;

(B) A revision that affects the recoupment under paragraph (a)(8) of this section; and

(C) Any other revision that is a numeric, non-clerical change.

(v) The lender must provide the veteran with a final loan comparison disclosure (in a format specified by the Secretary) on the date the lender provides to the veteran the Closing Disclosure required under 12 CFR 1026.19(f). The veteran must certify, following receipt of the final loan



comparison disclosure, that the veteran received the initial and final loan comparison disclosures required by this paragraph.

(vi) Regardless of whether the lender must provide the veteran with a Loan Estimate under 12 CFR 1026.19(e) or a Closing Disclosure under 12 CFR 1026.19(f), the lender must provide the veteran with the initial and final loan comparison disclosures. Where the lender is not required to provide the veteran with a Loan Estimate or a Closing Disclosure because the refinancing loan is an exempt transaction under 12 CFR 1026.3, the lender must provide the veteran with the initial and final loan comparison disclosures on the dates the lender would have been required to provide the veteran with the Loan Estimate under 12 CFR 1026.19(e) and the Closing Disclosure under 12 CFR 1026.19(f), respectively, as if the refinancing loan was not an exempt transaction.

\* \* \* \* \*

(The Office of Management and Budget has approved the information collection requirements in this section under control number 2900-0601)

(Authority: 38 U.S.C. 3703, 3709, and 3710)

3. Amend § 36.4313 by:

a. Revising paragraph (d)(1)(i); and

b. In paragraph (e)(1)(i), removing the word “and” and adding, in its place, the word “or”.

The revisions read as follows:

**36.4313 Charges and fees.**

\* \* \* \* \*

(d) \* \* \*

(1) \* \* \*

(i) Fees of Department of Veterans Affairs appraiser and of compliance inspectors designated by the Department of Veterans Affairs except the following:

(A) Appraisal fees incurred for the predetermination of reasonable value requested by others than veteran or lender; and

(B) Appraisal fees incurred for the purpose specified by § 36.4307(a)(10)(v) of this subpart.

\* \* \* \* \*

[FR Doc. 2022-23387 Filed: 10/31/2022 8:45 am; Publication Date: 11/1/2022]